Dora
Department of Regulatory Agencies

Division of Securities
Fred J. Joseph
Securities Commissioner

Bill Ritter, Jr.
Governor

Barbara J. Kelley
Executive
Director

September 22, 2010

Jeffrey G. Pearson, Esq.
1570 Emerson Street
Denver, CO 80218

RE: Request for an Interpretative Opinion regarding Community Solar Gardens
Our File No. A 011-001

Dear Mr. Pearson:

The staff of the Division of Securities ("Staff") received your written request regarding Community Solar Gardens on August 18, 2010. Specifically, you request the Division of Securities to issue an interpretive opinion under the Colorado Securities Act ("Securities Act") setting out general principles or guidelines that will be used by the Division in deciding whether the issuance, offer or sale of subscription interests in community solar gardens ("CSG") are securities as that term is defined by the Act. In addition, you set out a list of factors regarding CSGs that you want addressed in terms of their importance in reaching a decision as to whether these interests are securities.

Section 11-51-201(17), C.R.S. defines a "security" as including "...investment contract...or, in general, any interest or instrument commonly known as a 'security,'" among other instruments and transactions.[1] At § 11-51-101(2), C.R.S., the General Assembly declared that the Act "... is remedial in nature and is to be broadly construed to effectuate its purposes." The purposes of that Act, also found at § 101(2), are "to protect investors and maintain public confidence in the securities markets while avoiding unreasonable burdens on participants in capital markets." It has been determined by Colorado courts that this expansive language in the Act indicates an intent by the General Assembly to provide the flexibility needed to regulate investment programs devised by those who seek the use of the money of others in exchange for the promise of

1-51-102[1] The statutory definition of "security" under the Act is virtually identical to the definition under the federal Securities Act of 1933. *Lowery v. Ford Hill Investment Company*, 192 Colo. 125, 556 P.2d 1201 (1976).

profits. In this regard, the label attached to a particular investment program is not controlling; rather, a substantive appraisal of the economic or commercial realities of the offering is required.[2]

The seminal case articulating the test for determining whether a transaction, plan or offering constitutes an "investment contract" under the federal securities law was *SEC v. W. J. Howey Company*.[3] Colorado courts, when considering whether an investment vehicle is an "investment contract" and therefore a security, have adopted the *Howey* test.[4] An "investment contract" under Colorado law, is: (1) a contract, transaction, or scheme whereby a person invests his or her money (2) in a common enterprise, and (3) is led to expect profits derived from the entrepreneurial or managerial efforts of others.[5] Subsequently, this test was imported into Colorado's securities law, and has been applied by the appellate courts in this state to a variety of investments.[6]

From the Staff's review of your correspondence, and its reading of House Bill 10-1342 (the "CSG Act"), a retail customer of a qualifying utility purchases a "subscription," which is defined as a "proportional interest in solar electric generation facilities … with the renewable energy credits associated with or attributable to such facilities."[7] Subscriptions are obtained from subscriber organizations, whose sole purpose "shall be beneficially owning and operating a community solar garden."[8] Subscriber organizations can be structured as any entity permitted by Colorado law, and may enter into any type of ownership arrangement with any "third party" who builds, owns or operates a CSG.[9] A qualifying retail utility is required to purchase the electricity and renewable energy credits from the CSG, with the purchase to take the form of a "net metering credit against the … bill to each … subscriber … ."[10]

Undoubtedly, there are numerous variations as to how to structure a CSG, and an ownership arrangement between the subscriber, the subscriber organization, and any third party. In viewing these varying arrangements in light of what constitutes an investment contract under Colorado law, and without having the benefit of specific factual details of a particular arrangement that would define the underlying economic realities of a

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[2] *Lowery, supra*; *Jenkins v. Jacobsen*, 748 P. 2d 1318 (Colo. App. 1988).
[3] 328 U.S. 293, 66 S. Ct. 1100, 90 L. Ed. 1244 (1946) as modified by *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975).
[4] *See Lowery*, at 1205; *Toothman v. Freeborn & Peters*, 80 P.3d 804, 811 (Colo.App. 2002).
[5] *Toothman*, at 811 (Colo. App. 2003); *Joseph v. Viatica Mgmt., LLC*, 55 P.3d 264, 266 (Colo. App. 2002); *Feigin v. Digital Interactive Associates, Inc.*, 987 P.2d 876, 881 (Colo. App. 1999).
[6] *E.g., Sauer v. Hays*, 36 Colo. App. 190, 539 P. 2d 1343 (1975) (offer and sale of distributorships); *Lowery, supra.*, (offer and sale of condominium units); and *Griffin v. Jackson*, 759 P. 2d 839 (Colo. App. 1988) (loan scheme).
[7] Section 40-2-127(2)(a)(III), C.R.S.
[8] Section 40-2-127(3)(b)(III), C.R.S.
[9] Section 40-2-127(3), C.R.S.
[10] Section 40-2-127(5), C.R.S.

particular transaction, the Staff can provide general guidelines as to how it would view such a transaction in light of the definition of an investment contract.

The first requirement of the *Howey* test, that there be an investment of money, merely means that the purchaser is going to have to contribute some consideration for his right to take part in the investment program. In this case, the investment of money by the subscriber could take the form of a cash payment for the proportional interest in the facilities, but it could also consist of payment in the form of goods or services.

The common enterprise element of the *Howey* test requires that the promoter or some third person take some positive action to bring about the promised investor profit. Here, a common enterprise could exist between the subscriber, the subscriber organization, and/or a third party. The enterprise is the building, owning, and operating the solar garden facilities, and any benefit to the investor will largely be attributable to these efforts. It does not matter in this context if the subscriber organization attempts to limit the number of subscribers. The Securities Act provides that an investment contract "need not involve more than one investor nor be limited to circumstances wherein there are multiple investors who are joint participants in the same enterprise."[11]

The third element of *Howey* requires that the transaction be induced by the investors' expectation of receiving a profit. Here, the transaction could be structured so that the primary motive for the subscriber's participation in the subscriber organization is to receive the net metering credit against the subscriber's bill. Because the Securities Act is broadly construed to effectuate its purpose, one of which is the protection of investors, the Staff believes that the receipt of a net metering credit is a tangible economic benefit to the subscriber, and in a broader sense, a profit. The Staff notes that the benefit received by a subscriber can be similar in nature to the benefits received by a member in a cooperative association. Under the Securities Act, certain securities are exempt from the Act's registration requirement. One exemption is for "securities issued by a cooperative association defined in article 55 of title 7, C.R.S."[12] So, the Staff's view that a receipt of a tangible benefit can be a profit for purposes of an investment contract analysis is consistent with the exemption provided cooperative associations under the Securities Act.

The final element of the *Howey* test is whether the investor is led to expect profits derived from the entrepreneurial or managerial efforts of others. The Staff views managerial efforts as the exercise of the right to make decisions which will determine whether the investment is a success or a failure. When an investor invests money with another who will then use that money to generate a benefit or return, the investor risks his investment if it is a failure. If the investor participates in the management of the project and the decisions that affect the success of the project, then the investor has access to the information necessary to make such decisions, and does not need the protection of the securities laws. But when the investor is dependent on the management decisions of others, then he needs the protection of the securities laws, which require the full and fair

[11] Section 11-51-201(17), C.R.S.
[12] Section 11-51-307(j), C.R.S.

disclosure of all material facts regarding the investment. Given the wide variety of structures that a CSG can take, the Staff can envision CSGs where the subscriber is dependent upon the entrepreneurial or managerial efforts of others.

For purposes of the Securities Act, and based on the foregoing, the Staff is unable to conclude that a "security" does not exist with respect to the financial participation of subscribers in CSGs.

Compliance with the Securities Act generally requires the registration of the security,[13] licensure of persons who offer or sell securities,[14] and full and fair disclosure of all material facts regarding the security (the "anti-fraud" provision).[15] The registration provisions attempt to provide investors complete information about the project in which he is asked to invest, who controls it, and who will be making the decisions concerning the investment. The antifraud provision attempts to insure that the information is accurate.

It must be noted that the Securities Act offers a number of alternatives to registration of the securities. The Securities Commissioner has prescribed a "limited offering" registration procedure for securities if the issuer is located in Colorado, 80% of the proceeds from the offering are used for operations in Colorado, and the offering will not exceed one million dollars within any twelve month period.[16] Also, there are a number of types of securities that are exempt from the registration requirements of the Securities Act that may apply to CSGs. As mentioned earlier, securities issued by a cooperative association are exempt from registration.[17] Under certain conditions, securities issued by an entity organized and operated not for private profit are exempt.[18] Certain securities transactions are also exempt. Any securities transaction not involving any public offering is exempt.[19] Any securities transaction directed to no more than twenty persons and sold to not more than ten buyers is exempt.[20] The offer and sale of securities that are in compliance with Regulation D of the federal Securities Act of 1933 are exempt.[21] It is important to note that the person claiming the exemption has the burden of proving entitlement to the exemption.[22] By providing a list of possible exemptions, the Staff does not intend to imply that any of these exemptions will apply to CSGs.

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[13] Section 11-51-301, C.R.S.
[14] Section 11-51-401, C.R.S.
[15] Section 11-51-501, C.R.S.
[16] Section 11-51-304(6), C.R.S., Rule 51-3.3
[17] Section 11-51-307(j), C.R.S.
[18] Section 11-51-307(g), C.R.S.
[19] Section 11-51-308(i), C.R.S.
[20] Section 11-51-308(j), C.R.S.
[21] Section 11-51-308(p), C.R.S.
[22] Section 11-51-605, C.R.S.

With respect to licensure, the Securities Act provides that an individual effecting securities sales is required to be licensed as a "sales representative." An individual effecting securities sales for an issuer "is not a sales representative if the individual primarily performs … substantial duties for or on behalf of the issuer …, and the individual's compensation is not based, in whole or in part, upon the amount of purchases or sales" of the securities.[23] If an individual is not a "sales representative," he does not need to be licensed under the Securities Act.

The Staff recognizes the legislative declaration that the development of CSGs in Colorado is in the public interest and intended to broadened participation in utility customer ownership of small solar generation. But this laudatory purpose does not eliminate the incentive for fraudulent or deceptive practices by those who devise the countless and variable schemes through the use of the money of others on the promise of profits.

The Staff hopes that this discussion provides the sort of guidance that you are seeking. Please know that we are available to address any further questions or comments on the subject.

Sincerely,

Gerald Rome
Deputy Securities Commissioner

[23] Section 11-51-201(14), C. R.S.